

Latest Developments in relation to Benchmark Reform

1. International developments on benchmark reform and transition timeline

- i. Having discussed the impact of COVID-19 on global benchmark transition, the Financial Stability Board (FSB) published a statement on 1 July 2020, reaffirming its view that financial and non-financial sector firms across all jurisdictions should continue their efforts in making wider use of risk-free rates in order to reduce reliance on Interbank Offered Rates (IBORs) where appropriate and in particular to remove remaining dependencies on London Interbank Offered Rate (LIBOR) by the end of 2021.

The FSB and the Basel Committee on Banking Supervision (BCBS) published a report on Supervisory Issues associated with Benchmark Transition on 9 July 2020. The report includes, among other things, insights on remaining challenges to transition based on earlier surveys undertaken by the FSB, the BCBS and the International Association of Insurance Supervisors.

- ii. The Alternative Reference Rates Committee in the US (ARRC) published on 27 May 2020 a set of recommended best practices which include transition milestones specific to different types of financial products referencing USD LIBOR (e.g. floating rate notes, business loans, securitisations and derivatives). These milestones cover incorporation of fall-back provisions, technological and operational readiness of third-party vendors relevant to the transition, cessation of using USD LIBOR in new contracts and selection of fall-back rates.

Recognising that amending existing LIBOR-linked contracts will be challenging or even impossible for some products, the ARRC released in March 2020 a proposal for New York State legislation to minimise legal uncertainty and adverse economic impacts that may arise from LIBOR transition. The proposed legislation would: (a) prohibit a party from refusing to perform its contractual obligations or declaring a breach of contracts as a result of LIBOR discontinuation or the use of another benchmark recommended by the legislation; (b) establish that the benchmark recommended by the legislation is a commercially reasonable substitute for and commercially substantial equivalent to LIBOR; and (c) provide a safe harbour from litigation for the use of the benchmark recommended by the legislation.

- iii. The Working Group on Sterling Risk-Free Reference Rates in the UK (RFRWG) issued a statement on 29 April 2020 that includes an updated timeline for LIBOR transition. Specifically, lenders are expected to be in a position to offer non-LIBOR linked products by the end of Q3 2020 and to include contractual arrangements in all new and re-financed LIBOR-referencing loans products after the end of Q3 2020 to facilitate conversion to alternative reference rates (ARRs) ahead of end-2021. RFRWG also recommended that all new issuance of GBP LIBOR-referencing loan products that expire after the end of 2021 to cease by the end of Q1 2021.

The UK Government announced on 23 June 2020 its intention to bring forward legislation to give the Financial Conduct Authority (FCA) enhanced powers to direct the administrator of LIBOR to change the methodology used to compile the benchmark. These powers could help deal with “tough legacy” contracts that cannot transition away from LIBOR. The FCA will publish statements of policy on its approach to potential use of these powers after further engagement with stakeholders domestically and internationally.

- iv. At the meeting of the National Working Group on Swiss Franc Reference Rates on 7 May 2020, the Swiss Financial Market Supervisory Authority (FINMA) reiterated its expectation that market participants should undertake all necessary steps to ensure LIBOR will be replaced by the end of 2021. Market participants were also expected to make substantial progress in replacing CHF LIBOR-linked cash products with those referencing Swiss Average Rate Overnight by the end of 2020, to take proactive actions to issue new products referencing ARRs, and to undertake testing of relevant IT systems, models and tools.

2. Clarifications of the Basel Framework

- i. The BCBS published on 5 June 2020 a set of answers to frequently asked questions (FAQs) that the BCBS has agreed to add to the Basel Framework to help promote consistent interpretation of the framework. The FAQs cover, among others, a range of issues relating to the benchmark reform, including the definition of capital, market risk, counterparty credit risk, liquidity and operational risk.

3. Publication of compounded indices for ARRs

- i. The Bank of England (BoE) will start publishing a daily Sterling Overnight Index Average (SONIA) Compounded Index from 3 August 2020 to facilitate market participants’ calculation of compounded interest rates based on SONIA.
- ii. The Treasury Markets Association (TMA) started publishing in May 2020 the HKD Overnight Index Average (HONIA) Average (for fixed 30-day, 90-day and 180-day) and the HONIA Index in its website.